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Supreme Court, U.S.
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No. _____

In The

Supreme Court of the United States

October Term, 1996

In the Matter of SOUTHMARK CORPORATION,

Debtor.

SCHULTE ROTH & ZABEL,

Petitioner,

v.

SOUTHMARK CORPORATION,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Whether the existence of a "claim" under section 101(5) of the Bankruptcy Code always creates an "antecedent debt owed by the debtor" under section 547(b)(2) of the Bankruptcy Code.

II. Whether a debt can be owed before it is incurred.

LIST OF PARTIES

The following persons were parties to the proceedings in the Bankruptcy Court, District Court and Court of Appeals:

1. Petitioner/Defendant Schulte Roth & Zabel, a New York partnership

2. Respondent/Plaintiff Southmark Corporation

In accordance with Supreme Court Rules 14.1(b) and 29.6, Plaintiff Southmark Corporation has no parent company but has the following subsidiary corporations:

Care Centers, Inc.
Dominion Subsidiary Co.
Envicon Development Corp.
HCW Gas Processors, Inc.
Johnstown American Subsidiary Corporation, No. 3
Johnstown Investment Corp.
Monument Investments, Inc.
Riviera Utilities of Arkansas, Inc.
Southmark Acquisitions, Inc.
Southmark Acquisitions Canada LTD.
Southmark Commercial Management, Inc.
Southmark Financial Services, Inc.
Southmark Hospitality Management, Inc.
Southmark International, NV
Southmark Investment Group, Inc.
Southmark Life Group, Inc.
Southmark Life Subsidiary Corp.
Life Group Associates II, Inc.
Robert A. McNeil Corp.
Pacific Income Plan Company of California

LIST OF PARTIES – Continued

Pacific Investors Corp.
Southmark PS, Inc.
Southmark San Juan, Inc.
Southmark/Security National Investment Corp.
First Associated Management, Inc.
Southmark Tek, Inc.
North American Mortgage Investors
First HCW Pension Real Estate, Inc.
Southmark Investors, Inc.
Southmark Management Corp.
University Advisory Company, Inc.
SPC Holding Co.
Devam Corp.
Southmark Pacific Corp.
Pennpacific Properties, Inc.
Sopac Development Co.
West Texas Working Interest Corp.

The following additional persons were parties to the proceedings before the Bankruptcy Court and District Court who settled prior to oral argument before the Court of Appeals:

Defendant Garson L. Rice, Sr.
Defendant R&P Ventures, a North Carolina joint venture

The following persons were parties to the original Bankruptcy Court proceeding who were non-suited after each filed for bankruptcy:

Defendant Herbert B. Parks
Defendant Byron Investments, Inc.

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PETITION FOR WRIT OF CERTIORARI

Petitioner respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in the above-titled proceeding on July 2, 1996.

OPINIONS BELOW

Copies of the following Orders and Opinions are reprinted in the Appendix attached hereto:

1. Memorandum Opinion of the United States Court of Appeals for the Fifth Circuit entered on July 2, 1996 (*Southmark Corp. v. Schulte Roth & Zabel*, 88 F.3d 311 (5th Cir. 1996))
2. Memorandum Opinion and Order entered by the United States District Court for the Northern District of Texas, Dallas Division on September 6, 1995 (unpublished)
3. Order Granting Defendants' Summary Judgment Motions and Granting in Part and Denying in Part Plaintiff's Cross-Motion on Certain Issues entered by the United States Bankruptcy Court for the Northern District of Texas, Dallas Division on April 5, 1993 (unpublished)
4. Order Denying Petition for Panel Rehearing and Suggestion for Rehearing En Banc entered by the United States Court of Appeals for the Fifth Circuit on August 1, 1996 (*Southmark Corp. v. Schulte Roth & Zabel*, 95 F.3d 56 (5th Cir. 1996))

JURISDICTION

The decision of the Court of Appeals for the Fifth Circuit was rendered on July 2, 1996 and the Petition for Rehearing and Suggestion for Rehearing En Banc were denied on August 1, 1996. Jurisdiction over this Petition is conferred by 28 U.S.C. § 1254.

This case was originally filed as an adversary proceeding in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division as part of the bankruptcy case entitled *In re Southmark Corporation*, bankruptcy case no. 389-36324-SAF-11. The Bankruptcy Court had jurisdiction over the adversary proceeding under 28 U.S.C. § 1334(a) and because the matter constituted a core proceeding arising under title 11, 28 U.S.C. § 157(b)(2)(F). The District Court had jurisdiction over the appeal of the Bankruptcy Court's ruling under 28 U.S.C. § 158(a) and the Court of Appeals had jurisdiction over the appeal of the District Court's ruling under 28 U.S.C. § 158(d).

STATUTES INVOLVED

11 U.S.C. § 547(b) (Section 547 of the Bankruptcy Code) (emphasis on relevant section of statute)

§ 547. Preferences

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made –

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if –

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 101(5) and (12) (Sections 101(5) and (12) of the Bankruptcy Code)

§ 101. Definitions

(5) "claim" means –

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured;

* * *

(12) "debt" means liability on a claim; . . . .

STATEMENT OF THE CASE

Respondent Southmark Corporation ("Respondent" or "Southmark") filed for chapter 11 bankruptcy on July 14, 1989. Its Plan of Reorganization (the "Plan") was confirmed and subsequently became effective on August 10, 1990. Pursuant to the Plan, Southmark, as reorganized, became responsible for pursuing all causes of action of the former chapter 11 debtor. The adversary proceeding underlying this appeal was commenced on June 19, 1991 in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division (Felsenthal, J.) (the "Bankruptcy Court") to recover, *inter alia*, a certain $3.3 million alleged preferential

transfer[1] made to or for the benefit of the Defendants R&P Ventures ("R&P"), Garson L. Rice, Sr. ("Rice"), Herbert B. Parks ("Parks") and Byron Investments, Inc. ("Byron") (collectively, the "Parks Group"). Petitioner Schulte Roth & Zabel ("Petitioner") is a law firm, which was retained to represent the Parks Group in its pre-bankruptcy proxy contest against Respondent.[2]

The defendants answered the complaint, denying, *inter alia*, that the $3.3 million transfer was "for or on account of an antecedent debt owed" by Respondent before the transfer was made, as required by 11 U.S.C. § 547(b)(2), and raising various affirmative defenses. Subsequently, Petitioner and the remaining Parks Group defendants filed Motions for Summary Judgment on the antecedent debt issue. Respondent filed a Cross-Motion for Summary Judgment on section 547(b)(2), as well as on all other elements of 11 U.S.C. § 547(b).

The Bankruptcy Court heard oral argument on these Motions, and on April 5, 1993, granted Respondent's Motion in regards to all elements of section 547(b) *except* (b)(2). On this issue, the Bankruptcy Court determined that the $3.3 million transfer had *not* been on account of an antecedent debt owed by Respondent before the transfer was made, and therefore, summary judgment should be granted for Petitioner and the other defendants because Respondent could not meet its burden of proof on one of the essential elements of a preference with respect to the $3.3 million transfer. Appendix, pp. A-35-A-49. The Summary Judgment Order was interlocutory at the time it was rendered, but was certified for appeal.

Respondent appealed this ruling to the United States District Court for the Northern District of Texas (Kendall, J.)

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[1] The original and amended complaints included causes of action for the recovery of three other transfers which causes of action were settled and are not relevant to any appeal.

[2] Parks and Byron were nonsuited after each filed for bankruptcy. R&P and Rice settled prior to oral argument before the Fifth Circuit, leaving Petitioner as the only remaining Defendant.

(the "District Court"), who affirmed it[3] on September 6, 1995. Appendix, pp. A-18-A-34. Respondent appealed to the Fifth Circuit the District Court's ruling on both the Summary Judgment Order and the denial of its Motion for Leave to Amend. Oral argument was held on April 30, 1996.

On July 2, 1996, a Panel consisting of Chief Judge Politz, and Circuit Judges Wiener and Barksdale issued an opinion affirming the Bankruptcy Court's denial of the Motion for Leave to Amend, but reversing and remanding the Summary Judgment Order, holding that the alleged preferential transfer was made for or on account of an antecedent debt. Appendix, pp. A-1-A-17. Petitioner filed a Petition for Panel Rehearing and a Suggestion for Rehearing En Banc on July 16, 1996. Both were denied by Order entered August 1, 1996. Appendix, pp. A-50-A-51.

BACKGROUND FACTS[4]

This case has its roots in a proxy contest waged by the Parks Group, a group of dissatisfied shareholders of Southmark. Petitioner was counsel to the Parks Group. In March 1989, the Parks Group disclosed to the Securities and Exchange Commission ("SEC") its intention to propose nominees for election to Southmark's board of directors. In April

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[3] The Fifth Circuit appeal was actually two consolidated appeals. Prior to the Summary Judgment Order, the Bankruptcy Court had denied a motion by Respondent for leave to amend its complaint for the second time. After the Summary Judgment Order was appealed, all other causes of action remaining before the Bankruptcy Court were settled, and the Summary Judgment Order became a final judgment. Respondent then appealed the denial of its Motion for Leave to Amend, which was consolidated with the appeal of the Summary Judgment Order by the District Court. The District Court affirmed both Bankruptcy Court rulings.

[4] The issue in this case has always been one of law. The facts have never been disputed by the parties and, therefore, detailed citations to the factual record, set out at length in the briefs filed with the Fifth Circuit, have been omitted.

1989, the Parks Group publicly announced its intention to wage a proxy contest for the control of Southmark. Shortly thereafter, the Parks Group disseminated several statements expressing dissatisfaction with the activities of Southmark's then-current board of directors regarding, among other things, issues of corporate governance and management, executive/director compensation and transactions between the company and its directors and executives. In these SEC filings, the Parks Group indicated that it intended, to the extent legally permissible, to seek reimbursement of its costs and expenses incurred in connection with the proxy contest, and gave periodic estimates of these costs and expenses, all as required by applicable SEC regulations.

Between February and May 1989, each of the Parks Group and Southmark initiated various lawsuits in state and federal courts in connection with the proxy contest. Through its claims and counterclaims in the lawsuits, the Parks Group sought the following: (1) equitable and injunctive relief including the right to examine Southmark's record of shareholders, and (2) judgments (a) blocking the implementation of, and declaring null and void, a Southmark anti-takeover "poison pill" provision, (b) prohibiting Southmark directors from soliciting proxies unless specific disclosures were made, (c) directing Southmark directors to cure certain deficiencies in their proxy statement, and (d) forcing Southmark and its directors to refrain from postponing a scheduled shareholders' meeting.[5] In two of its lawsuits and in one of its counterclaims, the Parks Group, in a boilerplate prayer for relief, requested that it be awarded the costs and disbursements, including reasonable attorneys' fees, incurred in these lawsuits.

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[5] In only one of the lawsuits, the Parks Group sought, in addition to injunctive relief, monetary damages in connection with the threatened postponement by the Southmark board of a scheduled shareholders' meeting. The Parks Group *only* sought that relief from the directors of Southmark personally, and *not* from Southmark itself.

An overall settlement of the proxy contest and related litigation was reached and documented by May 24, 1989. The substance of the settlement is more fully described in the Settlement Agreement dated May 24, 1989 (the "Settlement Agreement"), entered into between Southmark, the Parks Group, and certain other individuals. Petitioner was not a party to the proxy contest, any of the lawsuits or the Settlement Agreement. The Settlement Agreement provided for, *inter alia*, the termination of the proxy contest, a voice on the Southmark board for minority shareholders (including the Parks Group), the appointment of three nominees of the Parks Group to the Southmark board, the inclusion for two years of the current nominees in the board's slate of nominees recommended for election, the agreement by the Parks Group not to engage in a proxy solicitation in opposition to Southmark or other takeover activities and the settlement and dismissal with prejudice of the lawsuits. The Settlement Agreement also provided that upon execution, Southmark would reimburse the Parks Group for its costs and expenses, including attorneys' fees, incurred in connection with the proxy contest and related corporate governance litigation. The parties estimated these expenses to be $3.3 million.

Midday on May 24, 1989, prior to the execution of the Settlement Agreement by all the parties, Southmark transferred $3.3 million to Petitioner by wire transfer. In this instance, Petitioner was acting essentially as an escrow agent as an accommodation to Southmark. Petitioner was under instructions to return these funds to Southmark in the event the Settlement Agreement was not formally executed. The Settlement Agreement was formally executed later, early in the evening on May 24, 1989. On May 25, 1989, Petitioner transferred the entire $3.3 million to R&P by wire, R&P wrote checks for certain of the funds to Byron and Byron wrote a check to Petitioner in the amount of $1 million.[6] Southmark filed for bankruptcy less than 90 days later.

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[6] Respondent, in its amended complaint, has acknowledged that Petitioner is not an initial transferee of the $3.3 million. 11 U.S.C.

Subsequently, after confirmation of its Plan, Southmark filed suit against the Parks Group and its law firm, the Petitioner, to recover the $3.3 million transfer. The Fifth Circuit, in reversing the Bankruptcy and District Courts, determined that the $3.3 million transfer was for or on account of an antecedent debt owed by Southmark. The Fifth Circuit's conclusion in this case, that a debt can be owed before it is incurred (that is, before the contingency that triggers liability takes place), is in conflict with the plain meaning of the statute, the legislative history of the statute, and the decisions of other circuit courts and numerous lower courts and should be reviewed by this Court.

REASONS FOR GRANTING THE WRIT

To be avoidable as a preferential transfer under the Bankruptcy Code (11 U.S.C. § 101, *et seq.*), a transfer must be "for or on account of an *antecedent debt* ***owed*** by the debtor before such transfer was made." 11 U.S.C. § 547(b)(2) (emphasis added). The fundamental issue involved in this case is whether a contingent claim always constitutes an "antecedent debt **owed**" prior to the time the contingency occurs. A writ of *certiorari* is necessary because:

1. This issue has been inconsistently decided by the circuit and lower courts resulting in a confusing and conflicting body of case law regarding a fundamental principle of the Bankruptcy Code. These inconsistencies can only be resolved by this Court.

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§ 550(a)(1). The issue of whether or not Petitioner is some type of subsequent transferee of any portion of the $3.3 million from whom Respondent can recover a preference under 11 U.S.C. § 550(a) was never reached by the Bankruptcy Court because the Bankruptcy Court found that the transfer was not a preference under 11 U.S.C. § 547(b). This issue will now have to be resolved at trial by the Bankruptcy Court.

2. The Fifth Circuit misconstrued prior rulings of this Court and effectively nullified one half of section 547(b)(2) in direct disregard of the plain meaning of the statute and all principles of statutory construction as frequently enunciated by this Court. Entire provisions of a statute should not be completely disregarded by the Fifth Circuit and other courts.

3. By ignoring the legislative history of section 547(b)(2) that an antecedent debt must be **"owed,"** the Fifth Circuit has resurrected problems corrected by the adoption of the Bankruptcy Code in 1978. The statute should be applied as written by Congress, not as inconsistently rewritten by the Fifth Circuit and certain other lower courts.

I. In conflict with the plain meaning of the Bankruptcy Code, decisions of other Circuits and with its own prior decision, the Fifth Circuit has determined that a contingent claim constitutes a debt owed by the debtor prior to the occurrence of the contingency.

"And they all spoke at once, so that none of them knew
One word that the other had said."[7]

The Fifth Circuit held, in the opinion below, that the Parks Group's contingent claim for recovery of costs and attorneys' fees incurred in connection with a proxy contest and related corporate governance litigation constituted a *debt owed* or *incurred* by Southmark as of the date the Parks Group stated its intent to seek such reimbursement in the event it was successful – rather than as of the date the board of directors of Southmark contractually agreed to reimburse such expenses. Appendix, pp. A-13-A-14. Therefore, according to the Fifth Circuit, such debt was antecedent to its

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[7] LEWIS CARROLL, THE HUNTING OF THE SNARK: THE BARRISTER'S DREAM (London, Macmillan and Boston, Osgood 1876).

payment, and the $3.3 million transfer constituted a preference. Appendix, p. A-16.

The Fifth Circuit reached this conclusion by analyzing the Bankruptcy Code's definitions of "claim" and "debt," noting that "claim" is defined at section 101(5) of the Bankruptcy Code as a "right to payment," even if the right to payment is contingent upon the occurrence of a future event. "Debt," however, is defined in section 101(12) of the Bankruptcy Code as "*liability* on a claim" (emphasis added). Citing to the legislative history of section 101(12) and certain case authority, the Fifth Circuit concluded that a claim, even if contingent, always simultaneously results in the incurrence of a debt because the "terms 'debt' and 'claim' are coextensive: a creditor has a 'claim' against the debtor; the debtor owes a 'debt' to the creditor." Appendix, p. A-15 (*citing, e.g., Pennsylvania Dep't of Public Welfare v. Davenport*, 495 U.S. 552, 558 (1990)). Thus, the Fifth Circuit ignored the plain meaning of the statute and concluded that a debt can be "antecedent" and "owed" before it is incurred.[8]

Every court that has dealt with this issue agrees that, to determine if a payment is made for or on account of an antecedent debt owed by the debtor, the date the debt was incurred must be compared with the date the transfer

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[8] The Fifth Circuit based its decision on two cases which actually contradict its holding: *Energy Cooperative, Inc. v. SOCAP Int'l, Ltd. (In re Energy Cooperative, Inc.)*, 832 F.2d 997 (7th Cir. 1987) and *Southmark Corp. v. Marley (In re Southmark Corp.)*, 62 F.3d 104 (5th Cir. 1995), *cert. denied*, ___ U.S. ___, 116 S. Ct. 815 (1996). The Fifth Circuit failed to consider another case that supports its holding: *Upstairs Gallery, Inc. v. Macklowe West Dev. Co., L.P. (In re Upstairs Gallery, Inc.)*, 167 B.R. 915 (B.A.P. 9th Cir. 1994). Circuit Court cases which directly or, in effect, contradict the holding of the Fifth Circuit in the case at bar include: *Sigmon v. Royal Cake Co., Inc. (In re Cybermech, Inc.)*, 13 F.3d 818 (4th Cir. 1994); *Kallen v. Ash, Anos, Freedman & Logan (In re Brass Kettle Restaurants, Inc.)*, 790 F.2d 574 (7th Cir. 1986) and *Sunset Enters., Inc. v. B&B Coal Co.*, 38 B.R. 712 (W.D. Va. 1984), *aff'd*, 798 F.2d 1409 (4th Cir. 1986).

occurred.[9] However, in cases involving contingent claims, the courts have ignored the statutory language and no uniform judicial rule has developed for determining when a debt is incurred or owed by the debtor. The courts that directly address the issue often reach different conclusions based upon identical legal analyses and fact patterns that have no material distinctions.[10] Other courts ignore the issue completely, but reach the right result based on judicial fictions tailored to the facts or simple logic.[11] The threshold issue that must be

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[9] *See, e.g., Marley*, 62 F.3d at 106; *Upstairs Gallery*, 67 B.R. at 918; *Energy Cooperative*, 832 F.2d at 1001; *Makoroff v. Allegheny Graphics, Inc. (In re Allegheny Label, Inc.)*, 128 B.R. 947, 953 (Bankr. W.D. Pa. 1991); *Whittaker v. BancOhio Nat'l Bank (In re Lamons)*, 121 B.R. 748, 751 (Bankr. S.D. Ohio 1990); *Bob Grissett Golf Shoppes v. Confidence Golf Co. (In re Bob Grissett Golf Shoppes)*, 44 B.R. 156, 158 (Bankr. E.D. Va. 1984).

[10] *Compare, e.g., Upstairs Gallery* (in preference action to recover lease termination payment, debt incurred on date lease executed); *Martin v. BarclaysAmerican/Leasing, Inc. (In re Martin)*, 117 B.R. 243 (Bankr. N.D. Tex. 1990) (in preference action to avoid lien securing lease guaranty, debt incurred when lease executed); and *Bob Grissett Golf Shoppes* (in preference action to avoid payments made under settlement of breach of contract suit, debt arose when contract entered into between the parties) *with Marley* (in preference action to recover payments made in settlement of breach of employment contract/severance obligations, debt arose when contract breached); *Energy Cooperative* (in preference action to recover breach of contract damages, debt incurred when contract breached); *Durant's Rental Center, Inc. v. United Truck Leasing, Inc. (In re Durant's Rental Center, Inc.)*, 116 B.R. 362 (Bankr. D. Conn. 1990) (in preference action to recover settlement payments made after lease termination, debt incurred when lease was breached).

[11] *See, e.g., Brass Kettle Restaurants*, 790 F.2d at 576 (payment of contingent fee upon settlement of litigation not avoidable because law firm had equitable lien on unidentified future settlement proceeds as of the date the contingent fee agreement was signed); *Sunset Enters.*, 38 B.R. at 717 (court determined, with no analysis, that no antecedent debt for payment of equipment rentals because contract provided that obligation to make rental payments was contingent upon coal being mined); *Harman v. Sorlucco (In re Sorlucco)*, 68 B.R. 748, 752 (Bankr. D.N.H. 1986) (while a divorce

confronted is to determine the date upon which a contingent claim becomes a "debt" and whether the debt is "antecedent" and "owed" within the meaning of section 547. This issue has been addressed in other sections of the Bankruptcy Code,[12] and was resolved in cases dealing with former section 547(c)(2) of the Bankruptcy Code (the pre-1986 amendments "ordinary course of business" exception to preferences). *Nolden v. Van Dyke Seed Co. (In re Gold Coast Seed Co.)*, 751 F.2d 1118 (9th Cir. 1985) (debt not incurred on executory contract for delivery of seeds until seeds are delivered and debtor becomes liable to pay for the seeds); *Sandoz v. Fred Wilson Drilling Co. (In the Matter of Emerald Oil Co.)*, 695 F.2d 833 (5th Cir. 1983) (debt incurred when goods delivered or services provided under executory contract, not when invoice sent out); *Iowa Premium Serv. Co., Inc. v. First Nat'l Bank in St. Louis (In re Iowa Premium Serv. Co.)*, 695 F.2d 1109 (8th Cir. 1982) (*en banc*) (debt for interest payments on a note incurred when money used, not when note signed).[13]

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proceeding calls into existence various claims between the parties, no antecedent debt is created from such inchoate obligations until the decree is entered).

[12] Pursuant to 11 U.S.C. § 553, a creditor can offset a mutual prepetition debt it owes the debtor with the debt owed by the debtor. Therefore, courts must determine when such debts were incurred to insure they are mutual prepetition debts. *See United States Agricultural Stabilization and Conservation Serv. v. Gerth*, 991 F.2d 1428 (8th Cir. 1993) (in the setoff context, debt was incurred when contract was executed prepetition); *Sherman v. First City Bank of Dallas (In the Matter of United Sciences of America)*, 893 F.2d 720 (5th Cir. 1990) (debt incurred for setoff purposes when credit card reimbursement contract entered into prepetition and not when cardholders rescinded purchases postpetition and demanded refunds).

[13] While the Bankruptcy Amendments and Federal Judgeships Act of 1986 eliminated the section 547(c)(2) requirement that a debt be incurred within 45 days of payment in order to qualify for the "ordinary course of business" exception, the *Gold Coast Seed* and *Emerald Oil* cases, along with their Seventh Circuit counterpart, *Barash v. Public Fin. Corp.*, 658 F.2d 504 (7th Cir. 1981), are still cited for the principle that a debt is not

Each of these courts went through the *exact* same debt/claim analysis as those deciding the issue under section 547(b)(2), yet reached conclusions which cannot be reconciled with those of the Fifth Circuit in the case at bar.

In the case at bar, the Fifth Circuit ruled that the assertion of even the most remote contingent claim created a debt owed by Southmark as of the date the claim was first asserted, even though the event that triggered liability on the claim, that is, the debt – the agreement of Southmark's board of directors to reimburse the Parks Group for costs incurred in waging a proxy contest – actually occurred simultaneously with the transfer.

While this conclusion is consistent with the Ninth Circuit's holding in *Upstairs Gallery,*[14] it is inconsistent with the

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incurred until the goods are delivered or the services are provided, and the debtor becomes legally obligated to pay for such goods and services. *See Marley*, 62 F.2d at 106; *Energy Cooperative*, 832 F.2d at 1001. *Barash* goes further and indicates that a debtor's obligation to pay first arises "whenever the debtor obtains a property interest in the consideration exchanged giving rise to the debt." *Barash*, 658 F.2d at 509. Petitioner does not know what consideration the Parks Group exchanged with Southmark that would have made Southmark liable for the Parks Group's proxy fight costs and expenses at the time the proxy contest and related litigation were commenced, and Southmark does not appear to allege that any such consideration existed.

[14] In *Upstairs Gallery*, the debtor entered into a five-year lease agreement with a shopping center. 167 B.R. at 916. Within ninety days of the debtor's bankruptcy, the landlord and the debtor entered into a termination agreement under which the debtor paid $38,000 to the landlord as a lease termination payment. *Id.* The Ninth Circuit correctly determined that a debt is incurred when a debtor first becomes obligated to pay it, but then determined that the debtor's debt for termination damages to the landlord arose not when the lease was terminated, but on the day the lease was signed, despite the fact that on that day, the landlord's claim for termination damages was wholly contingent upon the lease being terminated. 167 B.R. at 918. Therefore, the termination payment was made on account of an antecedent debt owed by the debtor before the payment was made and constituted a preference. *Id.*

two cases the Fifth Circuit ostensibly relied upon in deciding the case below: *Marley* and *Energy Cooperative*. In *Marley*, Southmark and Marley entered into an employment contract that required Southmark to pay severance benefits in the event Marley's employment was terminated. 62 F.3d at 105. Under the Bankruptcy Code's expansive definition of "claim," the execution of the contract gave rise to a contingent claim by Marley against Southmark for severance benefits. 11 U.S.C. § 101(5). Subsequently, Southmark terminated Marley and the parties entered into a settlement agreement, whereby Marley received a check for $400,000 and Southmark received a release of any further severance obligations to Marley. 62 F.3d 105. In its suit to recover the payment as a preference, Southmark alleged (consistent with *Upstairs Gallery*) that the payment was on account of an antecedent debt owed by Southmark before the payment was made because Southmark's debt to Marley was incurred when Marley executed his employment contract and the contingent claim for severance benefits arose. 62 F.3d 106.

Not so, held the Fifth Circuit panel that decided *Marley*. "Our focus, therefore, is on the date the debt was incurred and the date the transfer occurred. . . . *A debtor incurs a debt when he becomes legally obligated to pay it.*" 62 F.3d at 106 (*citing In re Emerald Oil Co.*) (emphasis added). Thus, although a contingent claim may have arisen when Marley's employment contract was executed, the debt was not incurred or **owed** by Southmark until Marley was terminated, which was the same date that Southmark became legally obligated to pay and, just happened to be, the same date the payment was made. *Id.* Thus, Southmark's severance payment to Marley was not a payment on account of an antecedent debt owed and was not a preference. *Id.*

The Fifth Circuit failed to recognize that the case at bar is analogous to *Marley*: same debtor, a contingent claim, the occurrence of the contingency, a settlement agreement and a payment pursuant to and simultaneous with the execution of the settlement agreement. Indeed, this case presents an even

more compelling situation for ruling that there was no "antecedent debt owed." In the case at bar, unlike Marley, the Parks Group did not have any contractual rights giving rise to its contingent claim. All that the Parks Group had was a statement in some pleadings and SEC filings indicating that they intended to seek to recover costs and attorneys' fees if they were successful in their proxy contest – that is, the Parks Group had a contingent hope of reimbursement of their attorneys' fees if they were successful in gaining control of the Southmark board.[15]

The Fifth Circuit primarily relied upon the Seventh Circuit's ruling in *Energy Cooperative*. Appendix, p. A-15. While the Seventh Circuit found a preference to exist in that case, a careful review of the facts of the case and the court's analysis shows that *Energy Cooperative* is consistent with *Marley* and *inconsistent* with the case at bar. In *Energy Cooperative*, the debtor ECI entered into a contract with SOCAP for the purchase of oil in January, 1981. 832 F.2d at 999. On March 11, 1981, ECI repudiated the contract. *Id.* On April 16, 1981, ECI and SOCAP settled and ECI paid SOCAP $1.6 million as compensation for ECI's breach of the contract.

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[15] *See generally* MARC I. STEINBERG, SECURITIES REGULATION: LIABILITIES AND REMEDIES ¶ 11.01, p. 11-3 (1995) (stating that "the significant amount of money and time consumed by a proxy fight, and the *impossibility of recouping proxy fight costs if the insurgents failed to take control"* make it a less favorable method [than a tender offer] for obtaining control of a corporation) (emphasis added); *see also O'Neill v. Church's Fried Chicken, Inc.*, 910 F.2d 263, 265-66 (5th Cir. 1990) (describing the common law rule that allows shareholders to recover their attorneys' fees from the corporation *if they show they have conferred a substantial benefit* to the corporation as a result of their efforts). *O'Neill* was cited by the Fifth Circuit in its opinion (Appendix, p. A-4, n.4) which noted that *O'Neill* was a derivative action. It would seem that in a proxy contest, the only way to show substantial benefit is to succeed in taking over the company, thereby enabling the victor to request reimbursement from the new "friendly" board of directors.

Id. Subsequently, within ninety days of the settlement payment, ECI filed for bankruptcy. *Id.* The trustee sued SOCAP to recover the $1.6 million as a preference contending that "ECI had incurred a debt to SOCAP when it contracted to purchase the crude oil from SOCAP." 832 F.2d at 1001.

The Seventh Circuit conducted the same claim/debt analysis as the Fifth Circuit in the case at bar and in *Marley*, and as the Ninth Circuit did in *Upstairs Gallery*. However, the Seventh Circuit ultimately rejected the trustee's argument that ECI had incurred a debt to SOCAP when the contract was executed, that SOCAP had a contingent claim for breach of contract damages when the contract was executed, and that ECI's debt for breach of contract damages was incurred on that same date. *Id.* The Seventh Circuit concluded that such a holding would conflict with the law of at least two circuits, both of which had held that in contingent claim situations, the contingency had to occur before the debt was incurred or owed. *Id.*, *citing Gold Coast Seed Co.*, 751 F.2d at 1119 (buyer incurs debt at time goods are delivered, not at time buyer makes contract); *Iowa Premium*, 695 F.2d at 1111-12 (although creditor has contingent claim for future interest when note is signed, the debtor incurs debt for interest on note when funds are used and interest falls due, not when note is executed). The Seventh Circuit then proceeded to hold that the debt was owed by ECI on the date it repudiated the contract. 832 F.2d at 1002. This holding is consistent with that of the Fifth Circuit in *Marley*, but inconsistent with that of the Ninth Circuit in *Upstairs Gallery*. Note that because ECI repudiated the contract one month before it paid SOCAP, an antecedent debt was owed by ECI before the payment was made and the payment was preferential. *Id.* Had ECI paid SOCAP on the date it repudiated the contract, the result would have been the same as in *Marley* – no antecedent debt owed and no preference.[16]

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[16] A lower court case with a fact timetable identical to *Energy Cooperative* but a fact scenario more similar to the case at bar, in that the

The Fifth Circuit's decision in the case at bar and the Ninth Circuit's decision in *Upstairs Gallery* cannot be reconciled with the Fifth Circuit's decision in *Marley* and the Seventh Circuit's decision in *Energy Cooperative*.[17] Perhaps,

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relief requested in the litigation was primarily equitable, is *Murray v. Withrow (In re PM-II Assoc., Inc.)*, 100 B.R. 940 (Bankr. S.D. Ohio 1989). In *PM-II*, the debtor was charged on September 3, 1985 by the State of Ohio with having violated the Ohio Anti-Pyramid Sales Law. Subsequently, the lawsuit was terminated after a consent judgment was entered into that required PM-II to cease and desist violating the law, establish a restitution fund and pay certain civil penalties. On October 15, 1985, subsequent to the entry of the consent decree, PM-II paid the penalties and on December 10, 1985, PM-II filed for bankruptcy. The trustee sought to avoid the payment of the penalties as a preference. The Court analyzed the definition of "debt" and held that the payments to the State of Ohio were recoverable as a preference because the "liability was incurred at the time the consent judgment was agreed to, which was prior to payment [of the civil penalties] and was not a contemporaneous exchange. *Id.* at 944. *But see Imperial Corp. of America v. Milberg, Weiss, Bershad, Specthrie & Lerach (In re Imperial Corp. of America)*, 144 B.R. 115 (Bankr. S.D. Cal. 1992) (attorneys' fees paid out of settlement of class action suit for breach of securities law, RICO and the like could be recovered as preference because debt to class plaintiffs arose when suit filed).

[17] Other courts have also determined, directly or by implication, that in a contingent claim situation, a debt is not owed until the contingency that creates liability occurs. *Cybermech*, 13 F.3d at 822 (debt incurred under conditional sales agreement requiring partial payment upon acceptance of prototype when buyer made down payment; therefore, subsequent reimbursement of down payment after seller's repudiation was on account of antecedent debt owed); *Brass Kettle Restaurants*, 790 F.2d at 576 (although decision was based on an equitable lien received on the date the contingent fee agreement was signed, in effect, court determined that payment of a lawyer's contingency fee does not constitute a preferential transfer because the payment is made contemporaneously with settlement of the litigation, and the litigation must be settled before a debt is owed to the lawyer); *Sunset Enters.*, 38 B.R. at 717 (Fourth Circuit determined, with little analysis, that payment of equipment rentals was not preferential because contract provided that obligation to make rental payments was contingent upon coal being mined and, therefore, no antecedent debt owed

contingent claims arising from executory contracts are different from other types of contingent claims. This interpretation would reconcile *Marley*, which held that a party to an executory contract only has a "claim" against the debtor when the contract is breached or rejected, 62 F.2d at 106, with *Energy Cooperative*. 832 F.2d at 1002. It would not, however, explain *Upstairs Gallery* because a lease is the quintessential executory contract, yet the Ninth Circuit used the contract execution date, not its breach date, as the debt-triggering event.[18] 167 B.R. at 918.

More importantly, the statement regarding when a claim arises under an executory contract is just plain wrong.[19] As

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until coal was mined); *Newman v. Bank of New England Corp. (In re Bank of New England Corp.)*, 187 B.R. 405 (Bankr. D. Mass. 1995) (payment setting up severance escrow was not on account of an antecedent debt owed because finalization of employment agreement contingent upon specific severance terms being negotiated, despite fact that employee commenced employment nine months earlier under oral employment agreement with some severance package and, therefore, employment contract was simultaneous with establishment of escrow); *Southmark Corp. v. Bates, et al. (In re Southmark Corp.)*, No. 389-36324-SAF-11, Adv. No. 391-3415 (Bankr. N.D. Tex. Feb. 4, 1992, Felsenthal, J.) (contract gave defendants a contingent claim to a percentage of proceeds of asset sale, but no debt owed by Southmark until time of transfer because Southmark not legally obligated to pay defendants until sale of assets closed; therefore, payments made at closing not preferential); *Makoroff v. Allegheny Graphics, Inc. (In re Allegheny Label, Inc.)*, 128 B.R. 947, 953 (Bankr. W.D. Pa. 1991) (debt for payment of commission was not incurred until either buyer and seller were introduced or sale closed).

[18] While *Iowa Premium* involves a repealed statutory provision, the executory contract distinction would not explain the *Iowa Premium* decision, which follows the executory contract line of cases, because a promissory note is *not* an executory contract. 695 F.2d at 1111.

[19] The statement is based on pre-Bankruptcy Code law. Under the Act, contingent claims were expressly excluded from treatment in bankruptcy cases and holders of executory contracts did not have "provable" claims until the contract was rejected or breached. *See, e.g., Mohonk Realty Corp. v. Wise Shoe Stores, Inc.*, 111 F.2d 287, 290 (2d Cir. 1940), *cert. denied*, 311 U.S. 654 (1940). Unfortunately, despite the fact

this Court has repeatedly stated, the definition of claim is intentionally broad so as to encompass all possible obligations of the debtor. *Pennsylvania Dept. of Public Welfare*, 495 U.S. at 558. As recognized by the Seventh Circuit in *Energy Cooperative*, this definition clearly includes all types of contingent claims, including those arising from executory contracts. 832 F.2d at 1001-02. While executory contracts are given some separate treatment under the Bankruptcy Code, the act of assuming or rejecting the contract does not create the "claim" – it merely determines whether the ultimate claim is classified and treated as an administrative claim or a prepetition unsecured claim. *See* 11 U.S.C. § 365(g); *In re Greystone III Joint Venture*, 995 F.2d at 1281.

The Fifth Circuit's decision in the case at bar and the Ninth Circuit's decision in *Upstairs Gallery* cannot be reconciled with the Fifth Circuit's decision in *Marley*, the Seventh Circuit's decision in *Energy Cooperative* and the Eighth Circuit's decision in *Iowa Premium*. The lower courts have become so accustomed to using language indiscriminately that the definitions of claim and debt have become meaningless and section 547(b)(2) has become a statutory nullity.

II. The decision of the Fifth Circuit effectively renders one-half of section 547(b)(2) of the Bankruptcy Code meaningless, in complete disregard of the rules of statutory construction frequently enunciated by this Court.

As this Court has stated on many occasions, the task of resolving the dispute over the meaning of a statute begins

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that the Bankruptcy Code abolished the concept of "provable claims" and contingent claims are expressly intended to be treated in bankruptcy cases (H.R. REP. No. 95-595, at 309 (1977)), many courts anachronistically still recite the old holdings to support construction of the Bankruptcy Code. *See Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture)*, 995 F.2d 1274, 1281 (5th Cir. 1991), *cert. denied*, 506 U.S. 821 (1992).

with the language of the statute itself. *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989); *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 685 (1985). Section 547(b)(2) clearly requires that three questions be answered: (1) Was there a *debt*? (2) If there was a debt, was it an *antecedent debt*? and (3) Was the debt *owed* by Southmark prior to the transfer?[20] If the answer to any one of these questions is no, the transfer was not a preference.

In this case, however, the Fifth Circuit limited its analysis to determining whether or not a *claim* existed. Once the Fifth Circuit concluded that a claim, albeit a contingent one, existed, it decided that all other elements of section 547(b)(2) were satisfied – effectively rewriting section 547(b)(2) beyond even its pre-Code language, as if it read "for or on account of a claim," in complete disregard of both the statute and its legislative history. It summarily dismissed Petitioner's arguments:

> (i) that Congress's use of the word "liability" in the definition of "debt" meant that while claim and debt might be coextensive, they were not always synonymous,
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> (ii) that a "claim" and a "debt" do not necessarily arise at the same point in time, and
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> (iii) that the language of section 547(b)(2) itself required not only that an "antecedent debt" exist, but that it be "owed" as well.

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[20] *See In re Brennan*, 187 B.R. 135, 153 (Bankr. D.N.J. 1995) ("To satisfy section 547(b)(2), however, a debt must be *both* 'antecedent' *and* 'owed by the debtor before such transfer was made'. . . . Under general principles of statutory construction, courts are to attempt to give meaning to all statutory language and to avoid determinations which render any statutory language a nullity. . . . [C]ourts should construe the clause 'owed by the debtor before the transfer was made' in section 547(b)(2) as adding some meaning to the prior words 'antecedent debt'.") (emphasis in original).

The Fifth Circuit's construction of section 547(b)(2) is in direct contravention of established Supreme Court law on statutory construction and the construction of the Bankruptcy Code. *Pennsylvania Dept. of Public Welfare*, 495 U.S. at 562 ("Our cases express a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment"). The Fifth Circuit should not be permitted to ignore the plain meaning of section 547(b)(2) by using the mantra of *stare decisis* to misconstrue Supreme Court case law, as well as case law in other circuits.

A. Not every claim constitutes a debt.

For most courts, the initial focus in connection with an analysis of section 547(b)(2) is on the definition of the word "debt." "Debt" is defined in the Bankruptcy Code as "liability on a claim." 11 U.S.C. § 101(12); *see also Marley*, 62 F.3d at 106; *Upstairs Gallery, Inc.*, 167 B.R. at 917; *Cybermech*, 13 F.3d at 822; *Energy Cooperative*, 832 F.2d at 1001; *Emerald Oil*, 695 F.2d at 837.

The courts then proceed to analyze the word "claim." "Claim" is defined broadly as a "right to payment" – whether that right is "reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5); *see also Marley*, 62 F.3d at 106; *Upstairs Gallery, Inc.*, 167 B.R. at 917; *Cybermech*, 13 F.3d at 822; *Energy Cooperative*, 832 F.2d at 1001; *Emerald Oil*, 695 F.2d at 837. Based on this analysis, and the legislative history of section 101(12), as well as on the 1990 decision of the Supreme Court in *Pennsylvania Dep't of Public Welfare*, the courts then uniformly conclude that "claim" and "debt" are "coextensive."

This is where the problem arises. Section 547 does not provide that any person who receives payment on a claim has received a preference. Congress defined the word "claim" in the Bankruptcy Code and used it in various sections where it intended it to be applicable. Claim is defined broadly because in some instances, such as discharge, policy dictates that all

that is needed is a claim – some small assertion of even the most remote obligation on the part of the debtor to the claimant. However, in other circumstances, policy dictates that there be more than a claim – that there be a debt, *i.e.*, ***liability*** on a claim.[21] For example, under section 303 of the Bankruptcy Code, a person cannot have a claim "contingent as to **liability**" and be eligible to file an involuntary petition. In other words, one must have a debt, rather than just a claim, in order to throw someone involuntarily into bankruptcy.

The statement that debt and claim are coextensive comes from the legislative history of section 101(12), defining "debt." H.R. REP. NO. 95-595, at 310 (1977); S. REP. NO. 95-989, at 23 (1978). Because the definition of "debt" is "*liability* on a claim," there is no question that *once a debt comes into existence*, debt and claim are coextensive. If Bubba owes a debt to Betty Jo (*i.e.*, is liable to Betty Jo), then Betty Jo has a claim against Bubba. The reverse is not always true. The fact that the definition of debt utilizes the word "claim" and adds a modifier – "liability" – makes it self evident that the concept of debt is intended to be less broad than the concept of claim. They are not always mirror images of each other. Quite simply, the literal definition of "debt" requires the existence of *both* (i) a "claim," as that term is defined in the Bankruptcy Code and (ii) "liability" on that claim.[22] To hold otherwise is to disregard the specific words

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[21] Petitioner will be the first to admit that the Bankruptcy Code is not a model of clarity or consistency in this regard. Both claim and debt are used hundreds of times in the Code and, oftentimes, they appear to be used interchangeably or without thought. But the need to limit certain rights and privileges under the Bankruptcy Code to debts rather than mere claims does exist.

[22] *But see New York Credit Adjustment Bureau, Inc. v. Just In-Materials Designs, Ltd. (In re Vasu Fabrics, Inc.)*, 39 B.R. 513, 517 (Bankr. S.D.N.Y. 1984) ("liability" has just as broad a definition as "claim" and encompasses contingent liabilities).

chosen by Congress. The Bankruptcy Code contains two different definitions for "claim" and "debt." The term "debt" is limited to those claims where liability has been incurred.

This analysis does not conflict with Supreme Court case law stating that debt and claim are coextensive. In many instances, if Betty Jo has a claim against Bubba, then Bubba owes a debt to Betty Jo. However, this is not always the case. If Bubba contracts to buy widgets from Betty Jo for delivery at some date in the future, at any point in time prior to delivery of the widgets, Betty Jo has a claim against Bubba for the price of the widgets contingent upon her delivery of the widgets and Bubba has a contingent claim against Betty Jo for the widgets or for damages if Betty Jo fails to deliver the widgets. However, during this interim period, Bubba does not yet owe a debt to Betty Jo and Betty Jo does not yet owe a debt to Bubba. A debt requires liability, and it is incurred only when the debtor becomes legally obligated to pay it.[23] If a debt has not been "incurred," liability has not been created.

It is within this gap period between claim and debt that contingent claims fall. A contingent claim is:

> [O]ne which the debtor will be called upon to pay only upon the occurrence or happening of an extrinsic event which will trigger the liability of the debtor to the alleged creditor and if such triggering event or occurrence was one reasonably contemplated by the debtor and creditor at the time the event giving rise to the claim occurred.
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> Thus, in the case of the classic contingent liability of a guarantor of a promissory note executed

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[23] *See, e.g., In re Emerald Oil Co.*, 695 F.2d at 836-37 (debt is legally incurred when services are provided, not when invoice is presented); *Marley*, 62 F.3d at 106 (debtor incurs a debt when it becomes obligated to pay it); *Energy Cooperative, Inc.*, 832 F.2d at 1001 (same); *Gold Coast Seed Co.*, 751 F.2d at 1119 (debt incurred when goods are delivered and debtor becomes obligated to pay for goods); *In re United Sciences of America*, 893 F.2d at 724 (in set off context, bank incurred debt when right to payment arose, not when bank asserted right).

> by a third party, both the creditor and the guarantor knew there would be liability *only if* the principal maker defaulted. *No obligation arises until such default.*

In re All Media Properties, Inc., 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980), *aff'd*, 646 F.2d 193 (5th Cir. 1981) (*per curiam*) (emphasis added). The fact that the filing of a bankruptcy triggers the policy of treating every possible contingent claim in some manner in the bankruptcy case does not support making every claim a debt. Some claims are contingent and only become debts when the contingency occurs (the debt is incurred).

In this case, the Fifth Circuit found that the statements of the Parks Group regarding their intent to seek to recoup their proxy fight costs and expenses constituted a claim. Assuming this is true, Southmark still had no *liability* on any claim asserted by the Parks Group until Southmark's board of directors agreed to incur such obligation, which happened when the Settlement Agreement was executed and the $3.3 million transfer was made. The proxy solicitation materials filed by the Parks Group with the SEC indicated only that the Parks Group intended to seek reimbursement of the proxy related fees and expenses *to the extent allowed by law*. The estimation of the dollar amount of those fees was included in the proxy solicitation materials because the SEC required such disclosure. Rule 14a-11 and Schedule 14(b), Securities Exchange Act of 1934, 15 U.S.C. § 77b, *et seq.* The costs and attorneys' fees relating to the proxy contest would only have been recoverable *if* the proxy contest had been successful *and* Southmark's board had then authorized their recovery. No liability existed and no consideration was exchanged based solely upon the Parks Group's statement of their intent to seek reimbursement of these expenses.

Nor do the boilerplate requests for recovery of attorneys' fees and expenses in the prayers of a few of the lawsuits constitute a debt of Southmark. These requests were included in the prayers because such requests are generally included in prayers for relief, just as they were included by Southmark in

its prayers for relief in the defensive lawsuits it filed. The requests contained in the lawsuits were only with regard to the attorneys' fees and expenses incurred in the lawsuits themselves, not those fees and expenses associated with the proxy contest. Southmark would *only* have incurred liability to pay these litigation-related fees and expenses if a court, in its discretion, and after an evidentiary hearing, ordered Southmark to do so after finding that the Parks Group had conferred a benefit on Southmark.[24]

In this case, no debt was incurred by Southmark on the contingent claim of the Parks Group in either the proxy contest or the related lawsuits for reimbursement of costs and expenses because Southmark had no *liability* on such claim. If such liability had existed, Southmark presumably would have booked such liability on its balance sheet. Reimbursement of fees and expenses was at all times contingent upon either an order of a court or the consent of the Southmark board of directors. That contingency occurred when Southmark executed the Settlement Agreement, and the transfer Southmark is seeking to avoid was made simultaneously with the occurrence of the contingency. There was no liability on the claim and, thus, no debt until the execution of the Settlement Agreement.

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[24] *See, e.g., O'Neill*, 910 F.2d at 265 (shareholders who pursue successful derivative suit may recover their attorneys' fees upon a showing that they conferred a substantial benefit to corporation); *Barton v. Drummond Co.*, 636 F.2d 978 (5th Cir. 1981) (court remanded for *evidentiary hearing* on whether class action plaintiffs' results were *sufficient* to allow them to recover attorneys' fees); *National Home Products, Inc. v. Gray*, 416 F. Supp. 1293 (D. Del. 1976) (court ordered corporation to pay proxy expenses incurred in connection with court-ordered board meeting after proxy litigants had been successful). In each of these cases, the debt owed by the corporate defendant to the plaintiff for reimbursement of the plaintiff's fees and expenses was contingent upon an order of the court finding for the plaintiff, not only on the corporate issues, but on the benefit of such substantive victory to the corporate entity.

B. Even if a debt existed, the debt had to be "antecedent" and "owed" by Southmark consistent with the plain meaning of section 547(b)(2) of the Bankruptcy Code.

Even if this Court concludes that "claim" and "debt" are synonymous, section 547(b)(2) requires that a debt be both "antecedent" and "owed" to constitute a preferential transfer. Consequently, one must compare when the debt was incurred with when the debt was paid. *See, e.g., Marley*, 62 F.3d at 106. The question before this Court is whether a debt is incurred or owed from the moment a contingent claim is asserted or whether it is the occurrence of the contingency that gives rise to a debt being owed.

Courts are required to consider that Congress intended to use the words it used in writing a statute. *Ron Pair Enters.*, 489 U.S. at 242. Section 547(b)(2) is unambiguous, and must be enforced according to its terms. Section 547(b)(2) specifically states that the payment must be on "account of an *antecedent debt owed by the debtor* before such transfer was made." 11 U.S.C. § 547(b)(2) (emphasis added). The phrase "antecedent debt" contained in section 547(b)(2) is amplified by the phrase "owed by the debtor before such transfer was made." According to Black's Law Dictionary, the word "owe" means "to be bound to do or omit something, especially to pay a debt." BLACK'S LAW DICTIONARY 1005 (6th ed. 1990). A debt does not become "owed" until the debtor becomes bound to pay, and logic dictates that a debt cannot be owed before it is incurred. Therefore, regardless of whether the assertions of the Parks Group amounted to a "claim" or a "debt," Southmark had no liability – contractual or otherwise – to reimburse the Parks Group for their proxy contest fees and expenses and, therefore, the debt was not "owed" until a court determined that Southmark was legally required to reimburse the Parks Group or until the parties contractually agreed that Southmark would do so. Therefore, to the extent there was a "debt," it was not antecedent or owed.

The Fifth Circuit ignored the phrase "owed by the debtor before such transfer was made," as if it had no meaning or purpose. This is fundamentally contrary to the rules of statutory construction. Congress rewrote the preference provision of the Bankruptcy Code in 1978. *Union Bank v. Wolas*, 502 U.S. 151, 160-61 (1991). The "reasonable cause to believe" the debtor was insolvent requirement was eliminated, a presumption of insolvency during the ninety days preceding the petition date and new exceptions were created, and the antecedent debt requirement was clarified and further limited. *Compare* Bankruptcy Act § 60 (former 11 U.S.C. § 96) *with* 11 U.S.C. §§ 547(b), (c)(2) & (f); *see also* H.R. REP. NO. 95-595, at 177-79, 372-75 (1977); REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, PTS. I AND II, H.R. DOC. NO. 93-137, at 201-11 (1973) (the "1973 COMMISSION REPORT").

Under the Bankruptcy Act, a transfer needed only to be "for or on account of an antecedent debt, made or suffered by such debtor while insolvent" to constitute a preference. 11 U.S.C. § 96(a) (repealed). The Bankruptcy Review Commission recognized the problems with this phrase and even recommended that the words "antecedent debt" be defined.

> Another difficulty with the present Act is that, although a preference is defined as a transfer in whole or partial satisfaction or securing of an "antecedent debt," there is no guidance to when a debt is "antecedent." . . . The Commission recommends that the potential harshness and uncertainty be eliminated by defining "antecedent debt" as a debt incurred more than five days before a transfer paying or securing the debt. . . . The Commission also recommends that "antecedent debt" be defined so as to exclude certain debts the payment of which do not infringe substantially on the goals of the preference provisions.

1973 COMMISSION REPORT, at 205.

The House Judiciary Committee agreed with the Bankruptcy Review Commission that the preference section of the

Bankruptcy Act was "hopelessly complex." REPORT OF THE COMMITTEE ON THE JUDICIARY, HOUSE OF REPRESENTATIVES, to accompany H.R. 8200 at 178, (1977) (the "JUDICIARY COMMITTEE REPORT"). The draft of the proposed revision to section 60 of the Act contained in the JUDICIARY COMMITTEE REPORT provided as follows:

> § 60a(1). A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by or perfected against such debtor [while insolvent]. . . .

JUDICIARY COMMITTEE REPORT, at 210.

This draft, however, did not solve the antecedent debt definitional problem pointed out by the Bankruptcy Review Commission. Subsequently, the ultimate drafters of the new Bankruptcy Code appear to have found defining antecedent debt to be too cumbersome. Because it was decided that the new preference statute would contain a presumption of insolvency, the "made or suffered by the debtor while insolvent" clause was removed. In its place, after "antecedent debt," the requirement that the antecedent debt be "*owed by the debtor before such transfer was made*" was added to the statute. This addition to the statute resolved the Bankruptcy Review Commission's concerns regarding the confusion over what was an "antecedent debt." An "antecedent debt" has to be **"owed by the debtor" before** it is paid.

A person cannot owe a debt before it is incurred. *See* 4 COLLIER ON BANKRUPTCY ¶ 547.05, at 547-39 (15th ed. 1996) ("Although 'antecedent debt' is not defined by the Code, essentially a debt is 'antecedent' if it is *incurred* before the transfer.") (*citing Gold Coast Seed Co.*). Therefore, even if the definition of "debt" encompasses contingent liabilities, the requirement that an antecedent debt be owed before it is paid eliminates the contingency issues because a debt, even a contingent one, *cannot be owed* until the contingency occurs.

This is exactly the holding of *Marley*, 62 F.3d at 106. *Certainly, if Southmark did not "owe" anything to Marley – a party with an employment contract and contractual rights – prior to termination and execution of the settlement agreement, then it did not "owe" anything to the Parks Group prior to the Parks Group obtaining either a court order finding substantial benefit or, as happened, the consent of Southmark's board of directors to reimburse the Parks Group's fees and expenses as set forth in the Settlement Agreement.* In the case at bar, even assuming the broadest definitions of claim and debt (*i.e.*, assuming the terms are essentially synonymous and encompass contingent obligations), Southmark was not *legally obligated* to reimburse the Parks Group for the Parks Group's fees and expenses – *i.e.*, Southmark did not "owe" or "incur" this debt – until the Parks Group was successful in the proxy contest (upon the execution of the Settlement Agreement). Therefore, no antecedent debt was *owed* by Southmark at the time the $3.3 million transfer was made.

Through its holding in this case, the Fifth Circuit has, in effect, returned the preference statute to its pre-Code language, recreating the very problems Congress sought to eliminate in 1978. In contingent claim situations, in order for a debtor to **owe** a debt, the contingency must occur. In the preference context, if the contingency occurs on the same date payment is made, the debt is not antecedent and its payment is not a preference. If the contingency occurs prior to the date of payment, a preference is received. Congress (and its minions) worked long and hard on the revised preference provision contained in the Bankruptcy Code. A writ is needed in this case to insure that section 547(b)(2) is consistently applied, as written, in its entirety by every court in every circuit.

CONCLUSION

The issue of whether a contingent claim constitutes an "antecedent debt owed" prior to the occurrence of the contingency is an important one. Not only is the recovery of preferences a significant fundamental policy of the Bankruptcy

Code, but the possibility of the recovery of certain payments in the event of a future bankruptcy affects the commercial practices of all creditors in their prepetition dealings with a potential debtor. While the facts of this case may be unusual, every bankruptcy case involves contingent claims of some sort and every bankruptcy case involves potential preference litigation. A writ of *certiorari* is necessary in this case to insure that section 547(b)(2) is consistently and uniformly applied as written.

Respectfully submitted,

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